

State of New Mexico LEGISLATIVE EDUCATION STUDY COMMITTEE

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State Capitol North, 325 Don Gaspar, Suite 200
Santa Fe, New Mexico 87501
PH: (505) 986-4591 FAX: (505) 986-4338
<http://legis.state.nm.us/lcs/lesc/lescdefault.asp>



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December 12, 2005

MEMORANDUM

TO: Legislative Education Study Committee

FR: Frances R. Maestas

**RE: STAFF BRIEF: EDUCATIONAL RETIREMENT FUND YEARLY REPORTS,
HJM 15 AND STUDY CHANGING EDUCATIONAL RETIREMENT
SYSTEM, HJM 9 & SJM 17**

The 2005 Interim Workplan of the Legislative Education Study Committee (LESC) includes a presentation by the Educational Retirement Board (ERB) on three memorials passed by the 2005 Legislature relating to the solvency of the Educational Retirement Fund.

ERB will address HJM 15, *Educational Retirement Fund Yearly Reports*, that requests the ERB to report yearly to its members and to the LESC on the status of the solvency of the Educational Retirement Fund. (see Attachment 1).

Gabriel, Roeder, Smith & Company, Consultants & Actuaries, will discuss a study that was conducted by the firm in response to HJM 9 and SJM 17 (identical), *Study Changing Educational Retirement System*, that request ERB to study the implications of moving from a defined benefit plan to a defined contribution plan for new education employees (see Attachment 2).

Issues:

- During the 2004 interim, the ERB notified the LESC that, as of the end of FY 04, the Educational Retirement Fund had become insolvent, which means that its funding period—i.e., the amount of time it takes a pension to become fully funded—had increased from 78 years in FY 03 to “infinity” in FY 04. The result is that, theoretically, the fund’s current rate of contributions would never amortize the fund’s unfunded actuarial accrued liability (UAAL) if no measures to remedy the situation were put into place.
- After considering a number of options to restore solvency to the fund, the 2005 Legislature passed legislation that was signed by the Governor, to increase the employer and employee contributions to the Educational Retirement Fund (see Attachment 3, *Laws 2005, Chapter 273*). The employer contribution will increase by 5.25 percent over seven years (a .75 percent increase per year) which will take the employer contribution from 8.65 percent in FY 05 to 13.9 percent in FY 12. The employee contribution will increase by .30 percent over four years (a .075 percent increase per year), which will take it from 7.6 percent in FY 05 to 7.9 percent by FY 09 (under the *Public Employees Retirement Act* (PERA), the employer contribution rate is 16.59 percent and the employee contribution rate is 7.42 percent).

Fiscal Year	Employer Contribution Rate	Cost of Increased Employer Contributions		Change in Employee Contribution Rate	Additional Revenue to ERB from Increase in Employee Contributions
FY 06	9.4%	\$17.5 million		7.675%	\$1.8 million
FY 07	10.15%	\$18.6 million		7.750%	\$1.8 million
FY 08	10.90%	\$19.5 million		7.825%	\$1.9 million
FY 09	11.65%	\$20.3 million		7.90%	\$2.0 million
FY 10	12.40%	\$21.2 million			
FY 11	13.15%	\$22.1 million			
FY 12	13.90 %	\$23.0 million			
Total		\$142.2 million			\$7.5 million

- To fund the employer contribution rate increase for FY 06, the 2005 Legislature appropriated approximately \$12.1 million to provide for public school employees and approximately \$5.4 million for higher education personnel.
- For FY 07, the employer contribution cost increase is approximately \$13.5 million for public school employees and approximately \$5.1 million for higher education personnel.
- According to ERB, assuming an actuarial assumption of not less than an 8.0 percent annual projected investment return and based on the implementation of employer and employee contribution rate changes as outlined in the following chart, the Educational Retirement Fund would meet the 30-year Governmental Accounting Standards Board (GASB) standard for amortization of ERB’s UAAL of \$2.4 billion (as of June 30, 2004) by FY 11 and ERB would reach the benchmark of an 80 percent funding ratio (actuarial assets as a percentage of actuarial liabilities) by 2019.

- According to ERB, an actuarial valuation as of June 30, 2005 indicates that as of June 30, 2005, ERB's UAAL is \$3.1 billion, a \$695.0 million increase from the June 30, 2004 UAAL of \$2.4 billion and the funding period to amortize the UAAL remains at infinity.
- According to the Legislative Finance Committee (LFC), however, the increase is not a surprise and was predicted in part to actuarial averaging of prior year investment losses. The LFC predicts that the UAAL will continue to increase until 2019 primarily because of baby boomer retirements and because increased employer and employee contributions need to occur before the fund will begin to reflect a turnaround. At this point in time, as long as actuarial assumptions relating to teacher pay, retirements, and annual investment returns of at least 8.0 percent return each year hold firm, the 2005 amendments will continue to improve the ERB solvency problem.
- The LFC also reports that a large UAAL is not a sign of pension fund distress and, despite the increase in the UAAL as of June 30, 2005, ERB is still on track to meet actuarial benchmarks. The decline in the funding ratio is expected to begin to reverse in FY 10. By 2009, the funding period should go from infinity to 54.2 years and continue to decline.
- ERB reports that in response to HJM 9 and SJM 17 (refer to introductory paragraph above), Gabriel, Roeder, Smith & Company, Consultants & Actuaries, will provide the committee with a report summarizing the firm's comparison between a defined benefit and defined contribution retirement plans, including an analysis of costs, benefits, and risk under each plan.
- ERB explains that New Mexico currently provides a defined benefit plan that provides retired employees with a fixed monthly annuity based primarily on the employee's salary history and the employee's years of service. Under a defined benefit plan, the employer bears the investment risk.
- A few other states offer defined contribution plans wherein an employer guarantees to make a predetermined fixed contribution into an account established by the employer for the employee. An employee may then elect or be required to also contribute some of his compensation. In a defined contribution plan, the employee bears the investment risk of meeting the employee's retirement income goals.
- According to ERB, the actuaries' study concluded that providing a defined contribution retirement plan for future ERB employees would either result in:
 - decreased retirement benefits;
 - increased total costs;
 - deteriorated funded position of the ERB defined benefit program provided for current ERB members; or
 - some combination of the above.

Background:

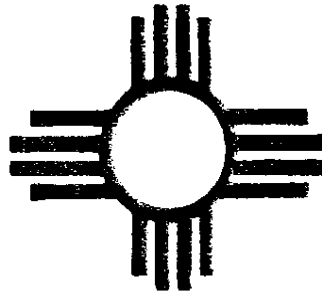
- In 1957, the Legislature enacted the *Educational Retirement Act* (ERA) to provide the education community with a vehicle for retirement through establishment of the Educational Retirement Fund.
- ERB employers number approximately 150 and include public school districts and charter schools, higher education institutions, special schools such as the New Mexico School for the Blind and Visually Impaired, and other state agencies such as the Public Education Department.
- Management of the Education Retirement Fund is under the ERB, which consists of a seven member board, the categories of which are statutorily determined and include the state superintendent of public instruction (now the Secretary of Public Education), the state treasurer, one member elected by the members of the New Mexico Association of Educational Retirees, one member elected by National Education Association-NM, one member elected by the American Association of University Professors, and two members appointed by the Governor.
- In order to attract and retain quality teachers in the profession, the 2001 Legislature enacted an LESC-endorsed amendment to the ERA (called “return to work”) to allow retired members to receive retirement benefits and salary following a one-year break in service beginning January 1, 2002, and continuing until January 1, 2012, without, however, allowing the member to accrue service credit during the return-to-work period.
- The 2003 Legislature enacted a measure to amend the PERA to allow PERA retirees who wait 90 days prior to returning to work to accept employment with a PERA-affiliated employer without suspension of their pension benefits but also without accruing service credit. These returning retirees and their respective employers must continue to pay PERA employee contributions into the fund.
- The 2003 Legislature also enacted a measure that (1) exempts PERA retirees from the ERA requirement to make contributions to the ERA Fund if they accept employment with a local ERA unit; (2) prohibits them from purchasing service credit for this time; and (3) requires the local administrative unit to make employer-share contributions to the Educational Retirement Fund.

Presenters:

For this presentation, Dr. Evalynne Hunemuller, Director, ERB; and Messrs. Chris Conradi and Flick Fornia, Senior Consultants, Gabriel, Roeder, Smith & Company, will discuss ERB’s responses to the memorials passed by the 2005 Legislature and other issues relating to the solvency of the Educational Retirement Fund.

Questions the committee may wish to consider:

1. What are the current actuarial assumptions for maintaining the efforts of the Legislature to bring the Educational Retirement Fund to solvency?
2. What strategies does ERB have under consideration to address actuarial soundness of the Educational Retirement Fund should ERB experience poor investment returns in future years?
3. How will additional funding to accelerate the employer contribution increases improve ERB's actuarial position?
4. What, if any, has been the effect on the fund of the implementation of the three-tiered licensure minimum salaries for teachers?
5. What, if any, has been the effect on the fund of the return-to-work provisions of the ERA?
6. In most years, the Legislature considers a salary increase for public school employees. How do salary increases for school personnel affect the solvency fund? Should the Legislature also consider a certain percentage for the ERB fund? If so, how would that percentage be calculated?
7. What other developments could affect the solvency of the fund?



The Legislature of the State of New Mexico

47th Legislature, 1st Session

LAWS 2005

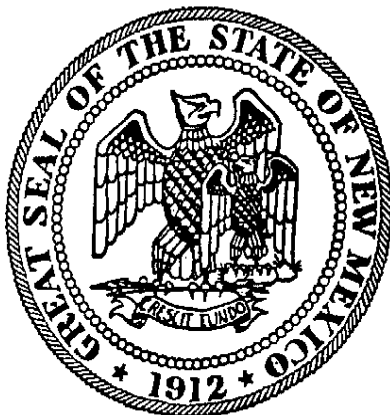
CHAPTER _____

HOUSE JOINT MEMORIAL 15

Introduced by

REPRESENTATIVE W. C. "DUB" WILLIAMS

REPRESENTATIVE RICK MIERA
REPRESENTATIVE TERESA A. ZANETTI
REPRESENTATIVE THOMAS E. SWISSTACK



FOR THE LEGISLATIVE EDUCATION
STUDY COMMITTEE

1 A JOINT MEMORIAL

2 REQUESTING THE EDUCATIONAL RETIREMENT BOARD TO REPORT YEARLY
3 TO MEMBERS AND TO THE LEGISLATIVE EDUCATION STUDY COMMITTEE ON
4 THE STATUS OF SOLVENCY OF THE EDUCATIONAL RETIREMENT FUND.

5
6 WHEREAS, the Education Retirement Act currently covers
7 more than sixty-five thousand active employees working in
8 approximately one hundred fifty public institutions in the
9 state of New Mexico; and

10 WHEREAS, these members will be entitled to benefits
11 under the act and will be, in whole or in part, dependent upon
12 the payments from the educational retirement fund for their
13 livelihood and well-being after they reach retirement age; and

14 WHEREAS, more than twenty-five thousand educational
15 retirement members are currently retired and receiving
16 benefits under provisions of the Educational Retirement Act;
17 and

18 WHEREAS, these members are, in whole or in part,
19 currently dependent upon the payments to which they are
20 entitled from the educational retirement fund for their
21 livelihood and well-being; and

22 WHEREAS, the state is currently experiencing a shortage
23 of qualified educational employees to provide vital services
24 to the citizens of the state; and

25 WHEREAS, the ability of public institutions to attract

1 qualified employees in these positions depends in part on the
2 ability of the state to ensure secure and attractive
3 retirement benefits; and

4 WHEREAS, according to the actuarial valuation of the
5 educational retirement fund for fiscal year 2004, the
6 financial stability of the fund has deteriorated dramatically
7 since the fiscal year 2002 and 2003 valuations; and

8 WHEREAS, projections for fiscal year 2005 of the fiscal
9 health of the fund show a continued decline unless action is
10 taken immediately; and

11 WHEREAS, it is in the public interest that members
12 covered under the terms of the educational retirement system,
13 and the legislature, be fully informed in a timely manner of
14 the status of the solvency of the fund; and

15 WHEREAS, the educational retirement board is the public
16 entity made responsible by the legislature for the enforcement
17 of the Educational Retirement Act;

18 NOW, THEREFORE, BE IT RESOLVED BY THE LEGISLATURE OF THE
19 STATE OF NEW MEXICO that the educational retirement board be
20 required to report yearly on the status of the solvency of the
21 educational retirement fund to members and to the legislative
22 education study committee; and

23 BE IT FURTHER RESOLVED that copies of this memorial be
24 transmitted to the educational retirement board and the
25 legislative education study committee.

S/ BEN LUJAN
BEN LUJAN, SPEAKER
HOUSE OF REPRESENTATIVES

S/ STEPHEN R. ARIAS
STEPHEN R. ARIAS, CHIEF CLERK
HOUSE OF REPRESENTATIVES

S/ DIANE D. DENISH
DIANE D. DENISH, PRESIDENT
SENATE

S/ MARGARET LARRAGOITE
MARGARET LARRAGOITE, CHIEF CLERK
SENATE



The Legislature of the State of New Mexico

47th Legislature, 1st Session

LAWS 2005

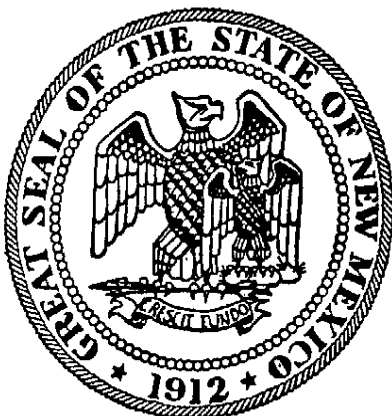
CHAPTER _____

HOUSE JOINT MEMORIAL 9

same as SENATE JOINT MEMORIAL 17

Introduced by

REPRESENTATIVE JEANNETTE WALLACE



FOR THE LEGISLATIVE FINANCE COMMITTEE

1 A JOINT MEMORIAL

2 REQUESTING THE EDUCATIONAL RETIREMENT BOARD TO STUDY THE
3 IMPLICATIONS OF CHANGING THE EDUCATIONAL RETIREMENT SYSTEM
4 FROM A DEFINED BENEFIT PLAN TO A DEFINED CONTRIBUTION PLAN FOR
5 NEW EDUCATION EMPLOYEES.

6
7 WHEREAS, New Mexico's current educational retirement
8 system established by the Educational Retirement Act is a
9 "defined benefit plan"; and

10 WHEREAS, in a defined benefit plan, a retired employee
11 receives a fixed periodic amount of money based on employer
12 and employee contributions to the plan, the employee's salary
13 history and the employee's years of service, and the employer
14 bears the investment risk of meeting the fixed retirement
15 benefit; and

16 WHEREAS, the educational retirement system is
17 experiencing solvency problems, including a funding ratio
18 expressed as a percentage of actuarial value of assets to
19 actuarial accrued liabilities of seventy-six percent, and an
20 unfunded actuarial liability of two billion three hundred
21 million dollars (\$2,300,000,000); and

22 WHEREAS, another plan for a retirement system is a
23 "defined contribution plan", in which an employer guarantees
24 to make a predetermined fixed contribution into an account
25 established by the employer for the employee and into which an HJM 9
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1 employee may elect to defer some part of the employee's
2 compensation, and in which plan the employee bears the
3 investment risk of meeting the employee's retirement income
4 goals; and

5 WHEREAS, the defined benefit plan and the defined
6 contribution plan each have advantages and disadvantages for
7 the employer and employee, and those advantages and
8 disadvantages should be compared to determine if a defined
9 contribution plan for new education employees would result in
10 a more financially sound retirement system that provides the
11 same or better retirement benefits as those now received by
12 retired educational retirement system members;

13 NOW, THEREFORE, BE IT RESOLVED BY THE LEGISLATURE OF THE
14 STATE OF NEW MEXICO that the educational retirement board be
15 requested to study the implications of moving to a defined
16 contribution plan for new education employees and submit its
17 findings to the legislative finance committee by September 30,
18 2005; and

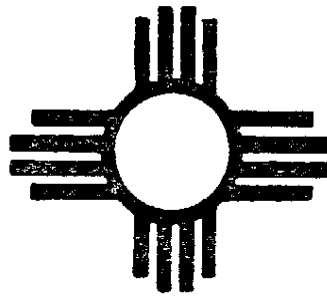
19 BE IT FURTHER RESOLVED that copies of this memorial be
20 transmitted to the educational retirement board and the
21 legislative finance committee.

S/ BEN LUJAN
BEN LUJAN, SPEAKER
HOUSE OF REPRESENTATIVES

S/ STEPHEN R. ARIAS
STEPHEN R. ARIAS, CHIEF CLERK
HOUSE OF REPRESENTATIVES

S/ DIANE D. DENISH
DIANE D. DENISH, PRESIDENT
SENATE

S/ MARGARET LARRAGOITE
MARGARET LARRAGOITE, CHIEF CLERK
SENATE



The Legislature of the State of New Mexico

47th Legislature, First Session

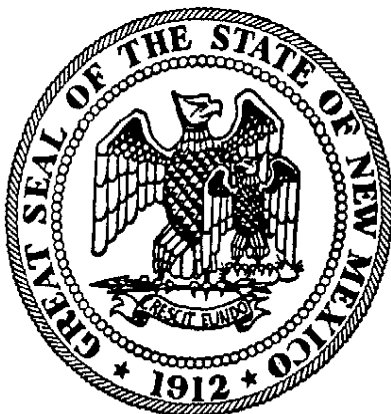
LAWS 2005

CHAPTER 273

SENATE BILL 181, as amended

Introduced by

SENATOR JOHN ARTHUR SMITH
SENATOR JOSEPH A. FIDEL



Chapter 273

AN ACT

RELATING TO EDUCATIONAL RETIREMENT; INCREASING EMPLOYER AND
EMPLOYEE CONTRIBUTIONS.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF NEW MEXICO:

Section 1. Section 22-11-21 NMSA 1978 (being Laws 1967,
Chapter 16, Section 144, as amended) is amended to read:

"22-11-21. CONTRIBUTIONS--MEMBERS--LOCAL ADMINISTRATIVE
UNITS.--

A. Each member shall make contributions to the
fund according to the following schedule:

(1) through June 30, 2005, an amount equal
to seven and six-tenths percent of the member's annual
salary;

(2) from July 1, 2005 through June 30, 2006,
an amount equal to seven and six hundred seventy-five
thousandths percent of the member's annual salary;

(3) from July 1, 2006 through June 30, 2007,
an amount equal to seven and seventy-five hundredths percent
of the member's annual salary;

(4) from July 1, 2007 through June 30, 2008,
an amount equal to seven and eight hundred twenty-five
thousandths percent of the member's annual salary; and

(5) on and after July 1, 2008, an amount
equal to seven and nine-tenths percent of the member's annual

1 salary.

2 B. Each local administrative unit shall make an
3 annual contribution to the fund according to the following
4 schedule:

5 (1) through June 30, 2005, a sum equal to
6 eight and sixty-five hundredths percent of the annual salary
7 of each member employed by the local administrative unit;

8 (2) from July 1, 2005 through June 30, 2006,
9 a sum equal to nine and forty hundredths percent of the
10 annual salary of each member employed by the local
11 administrative unit;

12 (3) from July 1, 2006 through June 30, 2007,
13 a sum equal to ten and fifteen hundredths percent of the
14 annual salary of each member employed by the local
15 administrative unit;

16 (4) from July 1, 2007 through June 30, 2008,
17 a sum equal to ten and ninety hundredths percent of the
18 annual salary of each member employed by the local
19 administrative unit;

20 (5) from July 1, 2008 through June 30, 2009,
21 a sum equal to eleven and sixty-five hundredths percent of
22 the annual salary of each member employed by the local
23 administrative unit;

24 (6) from July 1, 2009 through June 30, 2010,
25 a sum equal to twelve and four-tenths percent of the annual

1 salary of each member employed by the local administrative
2 unit;

3 (7) from July 1, 2010 through June 30, 2011,
4 a sum equal to thirteen and fifteen hundredths percent of the
5 annual salary of each member employed by the local
6 administrative unit; and

7 (8) on and after July 1, 2011, a sum equal
8 to thirteen and nine-tenths percent of the annual salary of
9 each member employed by the local administrative unit."

SB 181
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Diane D. Denish

Diane D. Denish, President
Senate

Margaret Larragoite

Margaret Larragoite, Chief Clerk
Senate

Ben Lujan

Ben Lujan, Speaker
House of Representatives

Stephen R. Arias

Stephen R. Arias, Chief Clerk
House of Representatives

Approved by me this 6th day of April, 2005

Bill Richardson

Governor Bill Richardson
State of New Mexico